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## Subsiding Away: Can California Homeowners Recover from their Insurer for subsidence Damages to their Homes

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# **Subsiding Away: Can California Homeowners Recover from their Insurer for Subsidence Damages to their Homes?**

Jeff Katofsky\*

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## I. INTRODUCTION

As California's population has risen over the past several years, so has the need for homes. Contractors and developers have worked diligently to fill that need. Unfortunately, hasty builders have been more concerned with the quantity of the homes they construct, rather than the quality. As a result, thousands of homeowners across California find themselves living in damaged, but not always dangerous, quarters.

By the time a homeowner realizes that her home is damaged, most contractors and/or developers are judgment proof or protected by statutes of limitations.<sup>1</sup> Left with no other alternatives, unhappy homeowners are now, more than ever, turning to their insurers to obtain the necessary funds to effect proper repairs.

Normally, the damage to an insured's home is concurrently caused by a conjunction of third-party negligence, earth movement and/or land subsidence. The damage to the home is usually in the form of cracked slabs and foundations causing damage to the interior of the home as well. What is commonly thought of as simple "settlement cracks" may be evidence of serious deficiencies in the foundation or underlying soils of the home. Third-party negligence can be any one of numerous errors by the contractor, soils engineer, developer and/or design professional, such as (1) negligent construction, (2) negligent or poor design, (3) use of substandard fill material, (4) negligent compaction of the soil, (5) defective work, (6) poor framing of the home, and (7) improper grading of the land. For purposes of this article, this type of damage and the subsequent losses will be referred to as "subsidence losses."

A normal homeowner would have one of the two basic types of homeowner's insurance policies: (1) Specified peril, or (2) "all-risk."

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1. CAL. CIV. PROC. CODE § 337.15 (West 1982 & Supp. 1988).

In a specified peril policy, the insurer and insured determine precisely which risks will be insured and set the premium payments accordingly. Thus, the reasonable expectations of the parties are set. The insurer can specify the risks it is willing to insure and the insured can purchase coverage for the perils against which she wants protection. For example, neither party would expect the insurer to pay for a theft under a policy which only covers fire.

The "all-risk" policy was a brain-child of the 1950s. In an "all-risk" policy, *all losses except those specifically excluded are covered*.<sup>2</sup> This is the broadest form of coverage and has been so interpreted by the courts. In an "all-risk" policy, the reasonable expectation of the insured is that the insurer will pay for all losses caused by a non-excluded peril.<sup>3</sup> In other words, the insured expects that she will be paid for any damage occurring to her home unless the damage fits into one of the handful of policy exclusions. Controversies arise because the insurer fails to provide for situations in which the insured's loss is caused by more than one peril. This is called the doctrine of multiple cause or concurrent proximate cause.<sup>4</sup>

Under California law, if the damage is concurrently caused by an excluded peril (such as earth movement) and a non-excluded peril (such as third-party negligence), the claim is covered under the "all risks of physical loss" homeowner's policy.<sup>5</sup> Insurance carriers have taken the position that coverage for such losses can only be afforded to the insured if the non-excluded cause of the loss is the moving or independent cause of the loss. Viewing all subsidence claims as earth movement, the insurer's position in a multiple causation loss is that an excluded peril's enhancement of the loss destroys coverage even if the other causes of the loss were non-excluded perils. Since earth movement, an excluded peril, always aggravates a subsidence loss,

2. This article will concentrate on the "all-risk" policy.

3. See *Wolf Mach. v. Insurance Co. of N. Am.*, 133 Cal. App. 3d 324, 183 Cal. Rptr. 695 (1982).

4. Cf. CAL. INS. CODE §§ 530, 532 (West 1972 & Supp. 1988).

5. The standard policy is the HO-3 edition policy written by the Insurance Services Organization ("ISO"), whose purpose is to standardize policies and forms for the insurance industry. The HO-3 policy can be separated into "Old language" and "New language" (colloquial terms used by lawyers, referred to as "dirt lawyers" by their colleagues who practice in this area). "Old language" is defined as homeowner's policies which were in effect prior to 1983/84, when third party negligence was added as an additional exclusion to the policy. Policies in effect after 1983/84 are referred to as "New language." Because insurance companies claim that the HO-3 edition homeowner's insurance policy is a trade secret, a copy cannot be obtained. However, it is the basis of all homeowner's insurance policies issued by all insurers. Existing homeowner's policies provide examples of the variations of the standard form.

this forces denial of virtually all subsidence claims. Recently, in light of court decisions finding coverage contrary to the insurer's position,<sup>6</sup> insurers have relied more on the technical notice provisions in the policy to defeat and deny claims.<sup>7</sup>

The insurer's position seems difficult to defend in light of black letter California law which establishes that: (1) ambiguities in the policy are interpreted against the insurer,<sup>8</sup> (2) policy exclusions are interpreted narrowly,<sup>9</sup> and (3) coverage is viewed as broadly as possible.<sup>10</sup> The rule proposed by insurers would give them an unfair advantage over the insured in a subsidence claim where the loss occurred because of multiple causes. Since almost all subsidence losses are concurrently caused by earth movement or flood (excluded perils) in conjunction with a non-excluded peril (i.e., some sort of third-party negligence), the insurer would almost never have to pay for such a loss. This rule is contrary to California case law,<sup>11</sup> the California Insurance Code,<sup>12</sup> and the reasonable expectation of the insureds who are told, when purchasing their policy, that they are buying *all* inclusive, *all* risk coverage.

Insurers use several justifications for denying subsidence claims. One or more of those justifications are usually used per claim. However, each has its weakness.

The earth movement exclusion is ineffective where the loss is proximately caused, in part, by a non-excluded peril, such as third-party negligence. Almost all policies contain a twelve month "notice of loss" provision. Here, the insurance adjuster—rarely an expert in soils geology—determines a date when she thinks the insured should have noticed the loss, or when the insured first noticed a crack in the driveway, and attaches that date to the loss. Then, the adjuster denies the claim because the insurer was not notified within twelve

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6. See *infra* notes 19-76 and accompanying text (section II of this article discusses court decisions expanding coverage despite exclusionary clauses).

7. See *infra* notes 77-104 and accompanying text (section IV of this article explores notice provisions and statutes of limitation).

8. See *Continental Casualty Co. v. Phoenix Constr. Co.*, 46 Cal. 2d 423, 430, 296 P.2d 801, 805 (1956).

9. See, e.g., *Bollinger v. National Fire Ins. Co.*, 25 Cal. 2d 399, 154 P.2d 399 (1944) (court did not allow defendant to use the statute of limitations defense for equitable reasons).

10. See *Fageol Truck & Coach Co. v. Pacific Indem. Co.*, 18 Cal. 2d 731, 747, 117 P.2d 661, 669 (1941).

11. See *infra* notes 19-76 and accompanying text (section II of this article discusses court decisions expanding coverage).

12. Cf. CAL. INS. CODE §§ 530, 532 (West 1972 & Supp. 1988).

months of that date. Under the "discovery of loss" rule,<sup>13</sup> this twelve month limitation does not begin to run until the insured discovers the damage and its cause—usually after an expert performs the appropriate testing on the property. This limitation, and the others to follow, ignore a well-established body of law on continuing losses and the fact that, until repaired, no "occurrence" date exists.<sup>14</sup>

The insurer generally uses the twelve month "suit against us" provision in the same manner as the twelve month "notice of loss" provision, except that the insurer claims that the insured failed to sue within the prescribed limitation.<sup>15</sup>

Also similar is the sixty day proof of loss requirement. Insurers deny claims based on the failure of the insured to file a proof of loss within sixty days. The sixty days is calculated on a backdate basis like the twelve month notice provisions. This ignores the fact that the sixty days does not begin to run until the investigation determining the full extent of the damages has been completed.<sup>16</sup>

Insurers also rely on the four year statute of limitation for breach of the contract. If the adjuster's determination of the date of loss is more than four years prior to the claim, the insurer denies on this basis as well.

Finally, in 1983 and 1984, all insurers rewrote their homeowner's policies to exclude damage concurrently or proximately caused by third-party negligence. The policies are commonly referred to as "New Language." Ignoring case law that would require the insurer to apply the language of the first policy issued,<sup>17</sup> the insurer cites the new language as a basis for denying the claim.<sup>18</sup>

This article has two objectives: (1) Establishing that subsidence-type losses are covered under the express "all-risk" (HO-3 Edition)

13. See *infra* notes 125-47 and accompanying text (section IV-B of this article discusses the "discovery of loss" rule).

14. See, e.g., *Pfeiffer v. General Ins. Co.*, 185 F. Supp. 605 (N.D. Cal. 1960); *California Union Ins. Co. v. Landmark Ins. Co.*, 145 Cal. App. 3d 462, 193 Cal. Rptr. 461 (1983); *Snapp v. State Farm Fire & Casualty Co.*, 206 Cal. App. 2d 827, 24 Cal. Rptr. 44 (1962); *Hughes v. Potomac Ins. Co.*, 199 Cal. App. 2d 239, 18 Cal. Rptr. 650 (1962).

15. The ISO Homeowner's, HO-3 Edition, policy contains a provision which states: SUIT AGAINST US. No action can be brought unless the policy provisions have been complied with and the action is started within one year after the date of loss.

16. Cf. *Associated Eng'rs Inc. v. American Nat'l Fire Ins. Co.*, 175 F. Supp. 352, 353 (1959) (recognizing that an "all risk" policy is unique because coverage attaches upon the fortuitous and extraneous happening of loss or damage from any cause whatsoever, unless specifically excluded).

17. If the first policy is issued prior to 1983, the "old language" policy is applicable. See *supra* note 5.

18. See *infra* note 77 and accompanying text.

homeowner's insurance policy; and (2) showing that the positions taken by insurers to deny claims under this type of policy are contrary to established case law. To accomplish these objectives, this article will explore the following: (1) Coverage issues, including, but not limited to, new language; (2) risk bearing; and (3) the notice provisions in typical homeowner's insurance policies.

## II. COVERAGE—DEFEATING THE EARTH MOVEMENT AND FLOOD EXCLUSIONS

In a typical disputed subsidence claim, the insured makes a claim under the homeowner's policy on the theory that she has suffered a continuing loss<sup>19</sup> to her home proximately caused by a concurrence of third-party negligence (by the developer, contractor, design professional, etc.) in conjunction with earth movement or flood.<sup>20</sup> Three lines of authority contribute to the present state of California law: (1) The doctrine that a policy exclusion is only applicable if the excluded peril is the efficient, primary and proximate cause of the loss;<sup>21</sup> (2) the concept of negligence as an insured peril in an "all risk" policy where various forms of third-party negligence or the insured's negligence is a covered risk of loss, absent a specific exclusion;<sup>22</sup> and (3) the concurrent causation doctrine—that there can be more than one proximate cause of any event—which dictates that if two distinct causes interact at the same time to produce the given result, one of which is a covered peril, there will be coverage.<sup>23</sup>

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19. See *infra* notes 105-156 and accompanying text (discussing the "date of loss" and "continuing loss" issues).

20. The landmark case of *Sabella v. Wisler*, 59 Cal.2d 21, 377 P.2d 889, 27 Cal. Rptr. 689 (1963) established this principle, affirmed and applied in *Sauer v. General Insurance Co.*, 225 Cal. App. 2d 275, 278, 37 Cal. Rptr. 303, 305-6 (1964), and *Gillis v. Sun Insurance Office Limited*, 238 Cal. App. 2d 408, 415-24, 47 Cal. Rptr. 868, 872-78 (1965). See also *State Farm Mutual Auto. Ins. Co. v. Partridge*, 10 Cal. 3d 94, 514 P.2d 123, 109 Cal. Rptr. 811 (1973); *Safeco Ins. Co. v. Guyton*, 692 F.2d 551 (9th Cir. 1982) (discussing the doctrine of concurrent proximate causation).

21. See *Sabella v. Wisler*, 59 Cal.2d 21, 377 P.2d 889, 27 Cal. Rptr. 689 (1963).

22. See *Associated Eng'rs, Inc. v. American Nat'l Ins. Co.*, 175 F.2d 352, 353 (N.D. Cal. 1959); *Premier Ins. Co. v. Welsh*, 140 Cal. App. 3d 720, 722, 189 Cal. Rptr. 657, 661 (1983).

23. See *Safeco Ins. Co. v. Guyton*, 692 F.2d 551 (9th Cir. 1982); *Wagner v. Director*, 658 F. Supp. 1530 (C.D. Cal. 1987), *rev'd on other grounds*, 847 F.2d 515 (9th Cir. 1988); *State Farm Mutual Auto. Ins. Co. v. Partridge*, 10 Cal.3d 94, 514 P.2d. 123, 109 Cal. Rptr. 811 (1973); *Cypress Grove Townhouse Project Comm. v. Covenant Mutual Ins. Co.*, 197 Cal. App. 3d 169, 242 Cal. Rptr. 708 (1987) (Pursuant to California Rules of Court sections 976(b) and 976.1, the California Supreme Court has ordered the *Cypress Grove* opinion depublished. As a result, the case cannot be cited as authority in California courts.); *Strubble v. United*

California cases have construed the "all risk" language contained in most homeowner's and homeowner association's insurance policies to allow recovery for property damage where none was apparently ever intended.<sup>24</sup> Recent policy language changes have restricted coverage, excluding losses concurrently caused by third-party negligence. Thus, if damage occurred during the policy period of older, less restrictive policies, those provisions may afford coverage. The three emergent lines of authority will now be fully explored.

#### A. Primary, Efficient Cause as Basis for Coverage

The primary efficient cause doctrine was first enumerated by the California Supreme Court in *Sabella v. Wisler*.<sup>25</sup> In *Sabella*, improper lot preparation caused a sewer line to break. The leaking resulted in lot subsidence and subsequent damage to plaintiffs' home.

In 1955, Wisler constructed the Sabella house over a quarry pit. The pit had been improperly filled and then sold to Sabella, who failed to conduct an independent soil inspection. In May 1957, National Union Fire Insurance Company issued an "all physical loss" policy to the Sabellas, agreeing to insure the house against all risks of physical loss except for specific exceptions, including losses caused by settling, cracking, shrinking, expansion of pavements, foundations, walls, floors or ceilings.

The trial court found that, while no damage occurred until May 1, 1959, sometime between November of 1958 and February of 1959, a sewer pipe began to leak near the house. The sewer outflow from the house infiltrated the unstable earth below the foundation, causing the house to settle to uneven elevations. Its foundations and walls cracked, its floors became out of level, and its doors and windows jammed—subsidence ranged from two to six inches.

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Services Auto. Ass'n, 35 Cal. App. 3d 498, 110 Cal. Rptr. 828 (1973). The depublished cases discussed in this article (with the exception of *American Star Ins. Co. v. American Employees Ins. Co.*, 210 Cal. Rptr. 836 (1985)) were affirmed and ordered depublished after the Supreme Court accepted *Garvey* for review. (Pursuant to California Rules of Court sections 976(b) and 976.1, the California Supreme Court has ordered the *Garvey* opinion depublished. As a result, the case cannot be cited as authority in California Courts.). These cases remain illustrative of the courts' current reasoning in subsidence cases.

24. See *infra* notes 52-4 and accompanying text. While this article is replete with cases involving single family homeowner's policies, it applies with equal vigor to property damage losses in condominiums, planned developments and common interest subdivisions. See *Cypress Grove*, 197 Cal. App. 3d at 169, 242 Cal. Rptr. at 708. See *supra* note 23 (*Cypress Grove* has been ordered depublished by the California Supreme Court).

25. 59 Cal. 2d 21, 377 P.2d 889, 27 Cal. Rptr. 689 (1963).



The court found the reasonable value of plaintiffs' home to be \$18,200 undamaged, but the reasonable fair market value in the damaged condition to be only \$10,000.<sup>26</sup> The Supreme Court recited:

In determining whether a loss is within an exception in a policy, where there is a concurrence of different causes, the efficient cause—the one that sets others in motion—is the cause to which the loss is to be attributed, though the other causes may follow it, and operate more immediately in producing the disaster. The virtual absence of subsidence damage in the prior four years of the existence of the house here in question clearly indicates that the broken pipe was the predominating or moving efficient cause of the loss.<sup>27</sup>

Rebuffing the insurer's argument that the loss was unfortuitous and not a "risk," the *Sabella* court relied upon *Snapp v. State Farm Fire & Casualty Company*,<sup>28</sup> where the court said:

After any movement of land has occurred, it might be said to have been 'inevitable' with semantic correctness, but such 'inevitability' does not alter the fact that at the time the contract of insurance was entered into, the event was only a contingency or risk that might or might not occur within the term of the policy. Moreover, the breaking of the sewer pipe and consequent induction of quantities of waste water into improperly compacted fill may be viewed as an unanticipated external event or casualty, operating to trigger the greatly accelerated action of possibly inherent vices.<sup>29</sup>

*Sabella* was followed by and applied in *Sauer v. General Ins. Co.*,<sup>30</sup> where the insurer alleged a lack of coverage under the "all risk" homeowners policy for foundation, wall, floor, and other damage from saturation and settlement of soils.<sup>31</sup> General Insurance Company claimed they were insulated from liability by exclusions against "earth movement," "water damage," and "settling and cracking." The court found that the plaintiffs' property damage resulted from leaky water pipes beneath their house.<sup>32</sup> Following *Sabella*, the *Sauer* court held that coverage existed since the efficient, proximate cause of the loss was the broken water pipe, an included peril.<sup>33</sup>

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26. *Sabella*, 59 Cal. 2d at 26, 377 P.2d at 892, 27 Cal. Rptr. at 692.

27. *Id.* at 31-2, 377 P.2d at 895, 27 Cal. Rptr. at 695 (citing 6 G. COUCH, INSURANCE § 1466 (1930)). See 6 G. COUCH, INSURANCE § 1463 (1930).

28. 206 Cal. App. 2d 827, 830, 24 Cal. Rptr. 44, 45-46 (1963).

29. *Sabella*, 59 Cal. 2d at 34, 377 P.2d at 897, 27 Cal. Rptr. at 697, (citing *Snapp v. State Farm Fire & Cas. Co.* 206 Cal. App. 2d 327, 330, 24 Cal. Rptr. 44, 45-46 (1962)).

30. 225 Cal. App. 2d 275, 37 Cal. Rptr 303 (1964).

31. *Sauer*, 225 Cal. App. 2d at 276, 37 Cal. Rptr. at 304.

32. *Id.* at 278, 37 Cal. Rptr. at 304.

33. *Id.* at 279, 37 Cal. Rptr. at 304. See also *Hughes v. Potomac Ins. Co.*, 199 Cal.

Thus, under *Sabella*, the moving, efficient cause of the loss, if an included peril, would give rise to coverage. However, courts began to expand this doctrine.

### *B. Extending Dominant, Efficient and Proximate Causes*

Soon after *Sabella* was decided, courts began to loosen the moving, efficient cause doctrine (i.e., the first link in the causation chain must be an included peril for coverage to be afforded) and began to rely more on whether the "dominant" cause, no matter which link, was an included peril.

In *Gillis v. Sun Insurance Office, Ltd.*,<sup>34</sup> a storm destroyed the insured's boat dock. The carrier argued the loss was caused by water action and waves, an excluded peril. However, the court, following *Sabella* and *Sauer*, found one of the causes was the windstorm, an included risk.<sup>35</sup> The wind caused a gangway to break loose, damaging a pontoon which kept the dock afloat. The court found that the original damage was caused by the gangway when it struck the dock. The loss arose from the windstorm. The court, finding coverage, held that the evidence was sufficient to sustain the trial court's finding that the windstorm was the dominant and efficient cause of the damage and loss.<sup>36</sup>

*Gillis* was followed by *Strubble v. United Services Automobile Association*,<sup>37</sup> which involved a claim under an "all risk" insurance policy. The carrier alleged that the earth movement exclusion prevailed despite earthquake coverage.<sup>38</sup> In 1967, an earthquake led to discovery of a landslide under the plaintiffs' 7,280 square foot panoramic ocean view estate. In 1968, the plaintiffs moved out as the landslide worsened, leaving only one-third of the house intact. When the carrier denied coverage, the Strubbles sued claiming an earthquake, an included coverage, triggered the landslide. The court held the efficient cause of the landslide was the included peril of an earthquake operating through the excluded peril of earth movement.<sup>39</sup>

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App. 2d 239, 18 Cal. Rptr. 650 (1962) (coverage found when subsidence damage was caused by rain, an included peril, concurrently with rainwater infiltration, an excluded peril).

34. 238 Cal. App. 2d 408, 47 Cal. Rptr. 868 (1965).

35. *Gillis*, 238 Cal. App. 2d at 420, 47 Cal. Rptr. at 875.

36. *Id.* at 424, 47 Cal. Rptr. at 878.

37. 35 Cal. App. 3d 498, 110 Cal. Rptr. 828 (1973).

38. *Strubble*, 35 Cal. App. 3d at 504, 110 Cal. Rptr. at 831.

39. *Id.* at 505, 110 Cal. Rptr. at 832.

*Gillis* and *Strubble* commenced the trend by courts to expand coverage when the included peril, working concurrently with an excluded peril, was the efficient cause of the damages. *Gillis* and *Strubble* were simply premonitions of what was to come. The concurrent cause doctrine first espoused by *Sabella*, had not yet completed its metamorphosis, as explained below.

### C. Concurrent Causation Expands Sabella

The ambiguity in the efficient, dominant cause approach is that it is not always possible to determine which cause is the efficient, moving or dominant cause of the loss. Usually, the causes are concurrent—i.e., they happen simultaneously. This issue finally reached the California Supreme Court ten years after *Sabella*, in *State Farm Mutual Automobile Insurance Co. v. Partridge*.<sup>40</sup> The court held that where one of a loss' two concurrent causes is an included peril, coverage is afforded.<sup>41</sup>

The insured in *Partridge* was covered under a homeowner's policy and an automobile policy, both issued by State Farm. The homeowner's policy, however, contained an exclusion for injuries arising out of "the use of an automobile." The trial court found the insured was negligent in driving his car off a paved road onto rough terrain, causing a concealed magnum pistol to discharge and injure his passenger.<sup>42</sup> The insured had modified the gun to give it a "hair trigger action," which the court found negligent and independent of any "use" of the car.<sup>43</sup>

The question presented was whether there was coverage under the homeowner's policy for the insured's negligent acts in modifying the gun.<sup>44</sup> The California Supreme Court, in finding the loss covered, stated:

Although there may be some question whether either of the two causes in the instant case can be properly characterized as the 'prime', 'moving' or 'efficient' cause of the accident, we believe that the coverage under a liability insurance policy is equally avail-

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40. 10 Cal. 3d 94, 514 P.2d 123, 109 Cal. Rptr. 811 (1973).

41. *Partridge*, 10 Cal. 3d at 94, 102, 514 P.2d at 123, 129, 109 Cal. Rptr. at 811, 817.

42. *Id.* at 99, 514 P.2d at 127, 109 Cal. Rptr. at 815.

43. *Id.* at 100, 514 P.2d at 127, 109 Cal. Rptr. at 815.

44. *Id.* at 103, 514 P.2d at 129, 109 Cal. Rptr. at 817.

able to an insured whenever an insured risk constitutes simply a concurrent proximate cause of the 'injuries.'<sup>45</sup>

*Partridge* became the leading case on multiple causation losses. Although *Partridge* dealt with physical damage to a person, its holding equally applies to property losses under similar "all-risk" homeowner's policies. Thus, *Partridge* was bootstrapped as applying to all concurrent losses occurring under the all-risk homeowner's policy. The following section discusses some of those cases as they were applied to "all-risk" homeowner's policies.

#### *D. Elimination of Prime Causes and Finding Coverage for Any Third Party Negligence*

After *Partridge*, courts began to apply the concurrent proximate cause doctrine to homeowner subsidence losses. *Safeco Insurance Company v. Guyton*<sup>46</sup> interpreted California law and found coverage under "all-risk" homeowner's policies issued by various insurance companies to residents of Palm Desert, California.<sup>47</sup>

Record rains in 1976, accompanied by Hurricane Kathleen, overflowed flood control facilities and inundated parts of Palm Desert with water. Appellants in this case were property owners who suffered extensive property damage from those flood waters.

Safeco's policies included standard exclusions for losses arising or resulting from, contributed to, or aggravated by "flood, surface water, waves, tidal-water or overflow of streams or other bodies of water."<sup>48</sup> Relying on this exclusion, Safeco denied the claims and brought a declaratory relief action.<sup>49</sup> Following *Partridge*, the court held that whenever an included peril constitutes simply a concurrent proximate cause of the damages, coverage exists, even though the excluded peril preceded the included peril.<sup>50</sup> Thus, even though the failure of the flood control structures (the excluded peril) preceded the negligent construction of the flood control devices (the included peril), the court found coverage because the negligent construction was a concurrent proximate cause.<sup>51</sup>

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45. *Id.* at 104-05, 514 P.2d at 130, 109 Cal. Rptr. at 818 (emphasis in original).

46. 692 F.2d 551 (9th Cir. 1982).

47. *Guyton*, 692 F.2d at 555.

48. *Id.* at 553.

49. *Id.*

50. *Id.* at 554-55.

51. *Id.* at 555.

The *Partridge* court had expanded the coverage available to homeowners by doing away with the *Sabella* court's preoccupation with finding that the included peril need be the "prime," "moving," or "efficient" cause of the loss or damage.<sup>52</sup> Both *Partridge* and *Guyton* expanded *Sabella* by requiring that the insured only prove an insured risk constitutes a *concurrent proximate* cause of the damages instead of the *prime, moving or efficient* cause. This interpretation construed the policies' exclusions narrowly, to the insurer's chagrin. Instead of allowing the insurer to deny multiple causation claims whenever an excluded peril aided in the loss, the court, consistent with the theory behind proximate causation<sup>53</sup> and the reasonable expectation of the insured who purchased an "all-risk" policy, required the insurer to pay for all losses that were proximately caused, in whole or part, by a non-excluded peril.

Another example of a situation where the court has found coverage where an excluded and an included peril gave rise to a loss is *Hughes v. Potomac Insurance Company*.<sup>54</sup> There, the court found the infiltration of rainwater, an excluded peril, and rain, an included peril, caused a rise in the groundwater which contributed to a landslide, leaving the insured's house precariously perched over a cliff.<sup>55</sup> The insurance carrier asserted as a defense that its policy covered the insured's structure and foundations, but not the soil or land underneath the building.<sup>56</sup> The policy language insured against all physical losses to the "dwelling." Finding ambiguity in the word "dwelling," the court held that the insured's dwelling suffered real and severe damage when the soil beneath it slid away and left it overhanging a thirty-foot cliff.<sup>57</sup> The court said that until the damage was repaired and the land beneath the building stabilized, the structure "could scarcely be considered a 'dwelling building'" in the sense that rational persons would be content to reside there.<sup>58</sup> Coverage was granted.

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52. *Id.* at 554-555 (citing *State Farm Mutual Auto. Ins. Co. v. Partridge*, 10 Cal. 3d 94, 104-05, 514 P.2d 123, 130, 109 Cal. Rptr. 811, 818 (1973)).

53. *Cf.* CAL. INS. CODE §§ 530, 532 (West 1972 & Supp. 1988).

54. 199 Cal. App. 2d 239, 18 Cal. Rptr. 650 (1962).

55. *Hughes*, 199 Cal. App. 2d at 244-5, 18 Cal. Rptr. at 652-3.

56. *Id.* at 245, 18 Cal. Rptr. at 653.

57. *Id.* at 249, 18 Cal. Rptr. at 655.

58. *Id.* *Accord Pfeiffer v. General Ins. Co.*, 185 F. Supp. 605 (N.D. Cal. 1960). In *Pfeiffer*, plaintiffs' home had been damaged by a landslide. In addition, the land beneath the house needed stabilization repairs. The court held that:

In the case at bar, it is manifest that the land underlying the house must be encompassed within the word 'dwelling' unless the policy is to be interpreted as illusory. It appears to this court, and the court finds, that no amount of repairs to

Although not confronted with a homeowner's policy but a contractor's "all risk" policy, the District Court in *Associated Engineers, Inc. v. American National Fire Insurance Company*<sup>59</sup> recognized that an "all risk" policy is a unique insurance policy because it does not specify the events which must cause damage before coverage attaches.<sup>60</sup> It is, according to the court, "a promise to pay upon the fortuitous and extraneous happening of loss or damage from any cause whatsoever," unless excluded.<sup>61</sup> The negligence of the contractor was found to be such an event since "the risk of negligence does not come within any exception to the policy and therefore it is an insured peril."<sup>62</sup>

As awareness of subsidence damage among homeowners has increased, the California courts have been inundated with subsidence claims in the past few years. In *Premier Insurance Company v. Welsh*,<sup>63</sup> the insurer brought a declaratory relief action under an "all risk" homeowners insurance policy.<sup>64</sup> A landslide destroyed the Welsh home after heavy rains. The trial court concluded that the primary and efficient cause of the landslide was heavy precipitation, an excluded peril, rather than a negligently maintained subdrain, a covered risk.<sup>65</sup>

Following *Sabella*, the Court of Appeal reversed, maintaining that the moving or efficient cause of the loss was the negligently maintained subdrain rather than the rainfall.<sup>66</sup> More significantly, following *Partridge* and *Guyton*, the court held the damaged subdrain was, at the very least, a concurrent proximate cause of the property loss incurred by the insureds which, alone, gave rise to the insurer's liability.<sup>67</sup> The court stated:

In the instant case, the causal sequence leading up to the loss of appellants' house began with the negligent installation of the sewer line in 1972. This damaged the subdrain underlying appellants'

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the present structure alone will cure the damage or replace the dwelling until the earth movement under the structure is stabilized.

*Id.* at 608. See *Snapp v. State Farm Fire & Casualty Co.*, 206 Cal. App. 2d 827, 24 Cal. Rptr. 44 (1962) (relying on *Pfeiffer*).

59. 175 F. Supp. 352 (N.D. Cal. 1959).

60. *Associated Eng'rs, Inc.*, 175 F. Supp. at 353.

61. *Id.*

62. *Id.* at 353-54.

63. 140 Cal. App. 3d 720, 189 Cal. Rptr. 657 (1983).

64. *Premier*, 140 Cal. App. 3d at 722, 189 Cal. Rptr. at 658.

65. *Id.* at 723, 140 Cal. App. 3d at 659.

66. *Id.* at 725, 140 Cal. App. 3d at 660.

67. *Id.* at 727, 140 Cal. App. 3d at 661.

property by impeding its capacity to release subsurface waters. . . . While it is true that the heavy rainfall was the first link in the causal sequence, the immediate or proximate cause of loss was the damage to the drain which set in motion the chain of events leading to the ultimate destruction of the dwelling. It is a well settled principle of law that the proximate cause is that cause which, in natural and continuous sequence, unbroken by an efficient intervening cause, produced the injury or damage complained of and without which such injury or damage would not have occurred.<sup>68</sup>

Turning to the concurrent causation approach as an independent basis for reversal, the court held the damaged subdrain was a concurrent proximate cause of the property loss.<sup>69</sup> Citing *Partridge* and *Guyton*, the court continued:

Since in the instant case the stipulated facts explicitly state that the earth slide resulting in the destruction of the dwelling would not have occurred if the subdrain had not been damaged, it is established as a matter of law that the damage to the drain was a concurrent proximate cause of the loss. This, of course, compels the conclusion that the judgment at bench must be reversed under the *State Farm* and *Safeco* rationale as well.<sup>70</sup>

The *Partridge* rationale, however, has been brought before the California Supreme Court in *Garvey v. State Farm Fire and Casualty Company*.<sup>71</sup> In *Garvey*, a San Francisco law professor took his homeowners insurance carrier to court when it refused to pay for property damage under the "all risk" insurance policy.<sup>72</sup> The Garveys lived in a sixty-year-old hillside home. In 1960, they added a bedroom and deck. In August, 1978, the bedroom addition physically separated from the rest of the house. During repairs of the addition, they

68. *Id.* at 725, 189 Cal. Rptr. at 660 (citing *Parker v. City and County of San Francisco*, 158 Cal. App. 2d 597 (1958)).

69. *Id.* at 728, 189 Cal. Rptr. at 662.

70. *Id.* See *Farmers Ins. Exch. v. Adams*, 170 Cal. App. 3d 712, 216 Cal. Rptr. 287 (1985) (coverage under all risk homeowner's policy affirmed since a concurrent cause of the damage was an included peril); *Cypress Grove Townhouse Project Comm. v. Covenant Mutual Ins. Co.*, 197 Cal. App. 3d 197, 242 Cal. Rptr. 708 (1987) (sand dunes working as a natural barrier to protect condominium project were eroded by waves; held, coverage under all risk policy; insurer required to repair barriers as well as damage to project). See *supra* note 23 (*Cypress Grove* has been ordered depublished by the California Supreme Court). Both *Adams* and *Cypress Grove* followed the *Partridge* rationale.

71. 227 Cal. Rptr. 209 (1986), *vacated and rev. granted*, 723 P.2d 1248, 229 Cal. Rptr. 663 (1986) (Pursuant to California Rules of Court sections 976(b) and 976.1 the California Supreme Court has ordered the *Garvey* opinion depublished. As a result the case cannot be cited as authority in California courts.). This case has been reprinted without change at 201 Cal. App. 3d 1174 to permit tracking pending review by the California Supreme Court.

72. *Garvey*, 227 Cal. Rptr. at 210.

learned that the addition was built without footings or structural connections to the house. The Garveys filed a claim and State Farm denied coverage relying on the earth movement exclusion.<sup>73</sup>

Seven months after the loss, State Farm offered to pay the \$11,500 damages under an agreement with plaintiffs that they "hold" the money while State Farm pursued its declaratory relief action to judgment. If State Farm prevailed, the Garveys were to return the money. Plaintiffs were also required to waive all rights to sue for bad faith. The Garveys refused the tender and filed suit against State Farm for bad faith.

Relying on *Partridge*, the trial judge granted a directed verdict on the coverage issue because third-party negligence, a non-excluded peril, was a proximate cause of the loss.<sup>74</sup> The appellate court reversed, claiming that the jury must decide the coverage issue.<sup>75</sup> In a rather bizarre and complex opinion, the appellate court concluded:

the question of which category the present case falls into was a matter for the jury to decide. It may be that the loss was due to the fact that the covered risk (negligent construction of the house addition) was dependent on the excluded risk (earth movement). In other words, if the negligently constructed house addition was the agency through which the earth movement caused the loss, then coverage would be denied under *Sabella*. On the other hand, if the house addition was negligently constructed such that the addition is what caused the earth to move with the resulting loss, then coverage exists. Finally, if the earth was caused to move independent of the house addition and the addition was tearing away from the house independent of the earth movement, with the two happening to join together to cause the loss, then coverage exists.<sup>76</sup>

The Supreme Court has heard oral argument on the *Garvey* case twice, the last time in September, 1987. For over two and one half years, the Supreme Court has failed to render an opinion.

The Supreme Court can rule upon *Garvey* in one of three ways, each having different ramifications: (1) the trial court ruling can be upheld, strengthening *Partridge* and making all subsidence claims caused by a conjunction of an excluded and non-excluded peril covered; (2) the Court of Appeal could be affirmed, reviving the *Sabella* line of reasoning and changing the homeowner's burden of

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73. *Id.*

74. *Id.*

75. *Id.* at 211, 219.

76. *Id.* at 219.



proof; or (3) the Supreme Court can remand for a new trial rendering the appellate court's opinion meaningless. Guidance from the Court is needed to solve this conflict in authority.

### III. NEW LANGUAGE AND BEARING THE RISK OF LOSS

#### *A. New Language*

The case authority discussed above has forced homeowners' insurance carriers to extend coverage to losses which they never intended to cover. Some insurance carriers reacted in 1983 by amending the language in standard homeowner's/homeowner association policies. In an effort to negate the concurrent causation doctrine, policy exclusions were rewritten to apply "regardless of any other cause or event contributing concurrently or in any sequence of the loss." In some instances, the word "all" has been excised from "all risk" and a newly expanded exclusion for "faulty workmanship, design and materials" is now frequently seen. The new language was specifically developed by insurers as a response to the California cases diluting traditional exclusions in "all risk" policies.

One court has held that evidence of the way a policy exclusion has been rewritten or revised for clarification or amplification has been held to be irrelevant where the loss occurred solely in the old policy period.<sup>77</sup> Thus, old language would still apply if the loss began prior to the policy changes in 1983-84.

Despite these policy revisions, attorneys, backed by the courts' historical tendency to find coverage, continue to apply existing case law to circumvent exclusionary language. Furthermore, all damage which occurred—or manifested—prior to the inception date of the new policies, will continue to be interpreted under the old policy language. As discussed in more detail below, attorneys and carriers will be confronted with the "continuing and progressive" property damage claims which may give rise to coverage under the old and new policies. The insureds and their attorneys will be relying on the old "all risk" concurrent causation analysis while the carriers and their counsel will be asserting the new language as a defense.

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77. *McKee v. State Farm Fire & Casualty Co.*, 145 Cal. App. 3d 772, 777-78, 193 Cal. Rptr. 745, 748 (1983).

### B. Spreading and Bearing the Risk

The insurance industry, in response to this legal trend, is temporarily seeking to minimize its losses through subrogation efforts against developers or by involving other insurance companies who issued policies during periods of continuing damage, particularly earth movement damage. *California Union Insurance Company v. Landmark Insurance Company*<sup>78</sup> discusses the subrogation issue among insurers. *California Union*, involving liability policies, concluded that where two or more insurance companies are on the risk during a period of continuous, progressive and deteriorating property damage, each carrier is jointly and severally liable.<sup>79</sup> The carrier on the risk when damage first occurs continues on the risk even after the policy period ends.<sup>80</sup>

Dirt lawyers<sup>81</sup> have extended the *California Union* rationale to homeowners' policies. The common consumer practice of shopping for the least expensive coverage may actually help homeowners find themselves in the enviable position of having two or more insurance companies on the risk. This practice will also free carriers, on the risk at the time the claim is made, to look to prior and subsequent carriers to spread the risk.

Recently, the courts have struggled with the question of liability of a continuous loss on multiple insurers. In *American Star Insurance Company v. American Employers Insurance Company*,<sup>82</sup> the insurance carrier for a gas pipe contractor brought a declaratory relief action against all other previous carriers for indemnification.<sup>83</sup> After holding that the damage caused by the defective pipe was continuous, yet one "occurrence" within the meaning of the policies' language, the court required all insurers to share in the loss pro rata.<sup>84</sup> The court reasoned:

Two facts are crucial to this determination. The first is the *cause* of the damage: the pipes were defectively manufactured. The re-

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78. 145 Cal. App. 3d 462, 193 Cal. Rptr. 461 (1983).

79. *California Union*, 145 Cal. App. 3d at 478, 193 Cal. Rptr. at 471.

80. *Id.* at 474, 476, 193 Cal. Rptr. at 468, 469.

81. See *supra* note 5.

82. 210 Cal. Rptr. 836 (1985) (Pursuant to California Rules of Court sections 976(b) and 976.1, the California Supreme Court has ordered the *American Star* opinion depublished. As a result the case cannot be cited as authority in California courts.).

83. *American Star*, 210 Cal. Rptr. at 836-37.

84. 210 Cal. Rptr. at 842.

sulting damage was, in a very real sense, preordained from the time the pipes were installed. And the source of the problem leads to the second crucial fact: damage occurred during each policy period. It was occurring from the time the pipes were installed and placed in use. This was a continuous degenerative condition. In our view, under these circumstances, it would be arbitrary to select some finite point, or points, to fix liability.<sup>85</sup>

Three years later, in the same appellate district, the court disagreed with *California Union* and the unpublished *American Star* analysis in *Home Insurance Company v. Landmark Insurance Company*.<sup>86</sup> In *Home Insurance*, based on stipulated facts between two insurers arguing over which company must bear the loss, the court held that "in situations involving continuing damage after the policy has expired, the insurer on the risk at the time the damage was first discovered is liable for the entire loss."<sup>87</sup> Realizing that this is contrary to well established principles, the court, in February, 1988, granted a rehearing.

A slew of attorneys then joined in the case as amicus and the case reappeared in November, 1988.<sup>88</sup> Although *Home Insurance* specifically disapproved of the *California Union* case,<sup>89</sup> the court also rightly realized that the *Home Insurance* case must be limited to its stipulated facts:

. . . we hold that as between two first-party insurers, one of which is on the risk on the date of the first manifestation of property damage, and the other on the risk after the date of the first manifestation of damage, the first insurer must pay the entire claim. We wish to stress that our holding is limited to the stipulated facts before us.<sup>90</sup>

*Home Insurance* threw a wrench into the law as it presently stands. If it can be established that a covered risk resulted in continuing and progressive property damage over a period of three years while three separate carriers insured the homeowner, the carriers are jointly and severally liable for the loss under *California Union*. The carriers, then, would be in a position to involve all three insurance carriers on a negotiable proportional basis. However, under the *Home In-*

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85. 210 Cal. Rptr. at 841 (emphasis in original).

86. 197 Cal. App. 3d 954, 243 Cal. Rptr. 202, 205 (1988).

87. *Home Insurance*, 197 Cal. App. 3d at 958, 243 Cal. Rptr. at 205.

88. *Home Ins. Co. v. Landmark Ins. Co.*, 205 Cal. App. 3d 1388, 253 Cal. Rptr. 277 (1988).

89. *Home Insurance*, 205 Cal. App. 3d at 1395, 253 Cal. Rptr. at 282.

90. *Id.* at 1392-96, 253 Cal. Rptr. at 280-82 (emphasis added).

insurance analysis, the first insurer on the loss bears the entire loss. Possibly, the California Supreme Court will grant review over the *Home Insurance* case and clarify this split in authority.

One additional complication may arise when two or more homeowners have owned the property during the same three year period. The first and second insurance companies insure the original homeowner during which time property damage first manifests itself and continues to progress. The house is sold, and immediately after, damage is discovered and a claim is filed under the current homeowner's policy. The threshold issue is whether the subject purchaser or her carrier can assert a claim under the previous two policies, assuming this involves no question of the assignability of rights by the original homeowner after the policy expires and the house is sold.<sup>91</sup> Assuming the prior policy can be validly assigned, the final carrier of three has a good argument to involve the original two insurers in order to spread the risk of loss under the *California Union* rationale.

Although there is now a split of authority, the California courts may still extend the rationale of *California Union* to all risk homeowner's policies and limit *Home Insurance* to its facts. The courts would probably rely on the insurance cases recited above, as well as *Snapp v. State Farm Fire & Casualty Co.*<sup>92</sup> and *Harman v. American Casualty Co.*<sup>93</sup> The same rationale applies to a comprehensive general liability policy. In *California Union*, the court held:

[U]nder the authority of *Snapp*, *Harman*, and *United States Fidelity & G. Co.*, we are constrained to hold that in a 'one occurrence' case involving continuous, progressive and deteriorating damage, the carrier in whose policy period the damage first becomes apparent remains on the risk until the damage is finally and totally complete . . . .<sup>94</sup>

In *Snapp*, the plaintiffs were insured for a term of three years under a fire policy with an "all risk" endorsement. The plaintiff's residence was built on fill which became saturated by unusually heavy rainfall. The unstable land beneath the residence began to move, causing structural and foundation damage. After finding coverage for damage to the soil and foundation underneath the dwelling, the

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91. See *University of Judaism v. Transamerica Ins. Co.*, 61 Cal. App. 3d 937, 132 Cal. Rptr. 907 (1976).

92. 206 Cal. App. 2d 827, 24 Cal. Rptr. 44 (1962).

93. 155 F. Supp. 612 (E.D. Cal. 1957).

94. *California Union*, 145 Cal. App. 3d at 476, 193 Cal. Rptr. at 469.

court reversed the trial court's finding of no coverage.<sup>95</sup> The insurer's obligation was not terminable on the date of expiration of the policy.<sup>96</sup> The court held that to permit the insurer to terminate its liability while the fortuitous peril during the policy term was still active would not be in accord with precedents or with the common understanding of the nature and purpose of insurance.<sup>97</sup> Termination would bestow an injustice on the insured, defeating the very protection for which premiums were paid.<sup>98</sup>

Once the event insured against occurs within the policy period, the carrier remains liable. It is immaterial that the damage continues beyond the policy period and thus cannot be fully determined. The carrier's responsibility when damage occurs becomes a contract matter, rather than a contingency. The court found that State Farm was required to pay its policy limits even though some of this award resulted from damages after the policy terminated.<sup>99</sup> In *Harman*, the court held that cancellation of a policy would not terminate liability where a continuing loss had begun until the cause of the loss had ceased.<sup>100</sup>

In sum, once a continuing, progressive loss begins, each company is on the risk until the damage ceases or is repaired.<sup>101</sup> The insurers are jointly and severally liable for not only the dwelling, but also the underlying soils<sup>102</sup> supporting the property.<sup>103</sup> Furthermore, each insurer will be liable under the language of the first policy issued to the insured.<sup>104</sup> Because of the recent trend in the courts of finding liability against insurers for subsidence losses, insurers have turned

95. *Snapp*, 206 Cal. App. 2d at 833, 24 Cal. Rptr. at 47.

96. *Id.* at 831-32, 24 Cal. Rptr. at 46.

97. *Id.* at 831, 24 Cal. Rptr. at 46.

98. *Id.* at 831, 24 Cal. Rptr. at 46.

99. *Id.* at 834, 24 Cal. Rptr. at 48. See also *Cypress Grove Townhouse Project Comm. v. Covenant Mutual Ins. Co.*, 197 Cal. App. 3d 169, 242 Cal. Rptr. 708 (1987) (*Cypress Grove* has been depublished, see *supra* note 23.); *Ash v. Safeco Ins. Co.*, 652 F. Supp. 148 (C.D. Cal. 1986); *Pfeiffer v. General Ins. Co.*, 185 F. Supp. 605 (N.D. Cal. 1960).

100. *Harman v. American Casualty Co.*, 155 F. Supp. 612, 613 (S.D. Cal. 1957). See also *California Union Ins. Co. v. Landmark Ins. Co.*, 145 Cal. App. 3d 462, 193 Cal. Rptr. 461 (1983).

101. *California Union*, 145 Cal. App. 3d 462, 193 Cal. Rptr. 461 (1983).

102. *Snapp v. State Farm Fire & Casualty Co.*, 206 Cal. App. 2d 827, 24 Cal. Rptr. 44 (1962); *Pfeiffer v. General Ins. Co.*, 185 F. Supp. 605 (N.D. Cal. 1960).

103. *Cypress Grove Townhouse Project Comm. v. Covenant Mutual Ins. Co.*, 197 Cal. App. 3d 169, 242 Cal. Rptr. 708 (1987) (*Cypress Grove* has been ordered depublished, see *supra* note 23) (the surrounding sand dunes protecting the project from waves were eroded by rainstorms).

104. *McKee v. State Farm Fire & Casualty Co.*, 145 Cal. App. 3d 772, 193 Cal. Rptr. 745 (1983).

to the technical notice policy provisions to avoid paying for the damage incurred by the insureds.

#### IV. NOTICE AND THE STATUTE OF LIMITATION DEFENSES

Unlike a fire or burglary loss under a homeowner's/homeowner association policy, first party claims relating to construction defects may not be discoverable until years after the project's actual design and construction. Most claims involve latent defects. The homeowner has a maximum ten years (or four years for patent defects) from substantial completion of the home to pursue a third party claim against the developer, contractor or design professional, or three years from the date of discovery.<sup>105</sup> Furthermore, the loss may have been discovered, the investigation undertaken, and repairs made by the homeowner/association before discovering that coverage may be afforded under the policy. Or the homeowner may have simply lived with the condition for years, after manifestation, before recognizing that he or she had a potential policy claim.

However, the insured may not be able to recover if she does not notify the insurer of the loss, since every policy defines the responsibility of the insured to notify the insurance company after a loss has occurred. These obligations include, *inter alia*, giving immediate written notice to the company and submitting a sworn proof of loss, defining the damage and cost to repair or replace to the carrier, within sixty days after requested.

Insurance policies also frequently contain a standard clause requiring the insured to comply with all policy provisions before bringing suit. That clause requires that any suit must be brought within one year of the loss. The provision's reasonable interpretation is one of creating certain conditions precedent to policy benefits and promoting due diligence on the part of the insured to notify the company.<sup>106</sup>

The notice provisions are required by statute. The Standard Fire Insurance Contract<sup>107</sup> enumerated by California Insurance Code section 2071<sup>108</sup> sets out the notice provisions as follows:

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105. See CAL. CIV. PROC. CODE §§ 337.1, 337.15 (West 1982 & Supp. 1988).

106. See 5A J. APPLEMAN, INSURANCE LAW & PRACTICE § 3481 (1970 & Supp. 1988). See also *White v. Home Mutual Ins. Co.*, 128 Cal. 131, 60 P. 66 (1900); *Sacombe v. Glens Falls Ins. Co.*, 45 Cal. App. 611, 188 P. 305 (1920).

107. The Standard Fire Insurance contract is the form used for the all-risk homeowners policy. See CAL. INS. CODE § 2071 (West 1972 & Supp. 1988).

108. *Id.*

#### Requirements in case loss occurs

The insured shall give written notice to this company of any loss without unnecessary delay, protect the property from further damage, forthwith separate the damaged and undamaged personal property, put it in the best possible order, furnish a complete inventory of the destroyed, damaged and undamaged property, showing in detail quantities, costs, actual cash value and amount of loss claimed; and within 60 days after the loss, unless such time is extended in writing by this company, the insured shall render to this company a proof of loss, signed and sworn to by the insured, stating the knowledge and belief of the insured as to the following: . . . . The insured, as often as may be reasonably required, shall exhibit to any person designated by this company, and subscribe the same . . . .

#### Suit

No suit or action on this policy for the recovery of any claim shall be sustainable in any court of law or equity unless all the requirements of this policy shall have been complied with, and unless commenced within 12 months next after inception of the loss.<sup>109</sup>

Insurers and their homeowner's policies rarely, if ever, follow the language of the Standard Fire Policy. Instead, they use more specific and/or restrictive language.<sup>110</sup> This more specific restrictive language may violate the Insurance Code.

California Insurance Code section 2079, entitled "Additional Permissive Clauses," allows only the following clauses to be added to the Standard Fire Policy: Those clauses (a) covering subject matter and risks not otherwise covered; (b) assuming greater liability than is otherwise imposed on the insurer; (c) granting insured permits and privileges not otherwise provided; (d) waiving any of the matters which may be waived and which avoid the policy or suspend the insurance; and (e) waiving any of the requirements imposed on the insured after loss.<sup>111</sup>

Insurance Code section 2079 does not provide for more restrictive or specific provisions. The Code only allows less restrictive provisions and definitions. Thus, normal insurer conduct and drafting leads to four possible alternatives. First, because the insurer has violated the Insurance Code, the restrictive provisions are dropped from the

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109. *Id.* Cf. *supra* note 15 (discussing the ISO Homeowners, HO-3 Edition, policy).

110. *See supra* note 15 and accompanying text (discussing the "Suit Against Us" provision).

111. CAL. INS. CODE § 2079 (West 1972).

policy, effectively waiving the insurer's right to use the notice provisions as a policy defense. Second, the court could choose to drop the insurers' more restrictive notice provisions and insert the section 2071 provisions in its place. Third, because the notice provisions do not match the statutory policy exactly, they are facially ambiguous. Ambiguities in insurance policies are interpreted against the drafter.<sup>112</sup> Finally, the insured would have a strong equitable estoppel or waiver argument based on the aforementioned.<sup>113</sup>

The insurer could avoid such an interpretation by complying with Insurance Code section 2080, which provides:

Except as otherwise provided by this Article, clauses imposing specified duties and obligations upon the insured and limiting the liability of the insurer may be attached to the standard form. Such clauses shall be in the rider or riders attached to the standard form of policy and shall be in type larger than pica or in capital letters measuring not less than eight one-hundredths (8/100ths) of an inch in height.<sup>114</sup>

The ISO HO-3 edition homeowners policy, used by most insurers, fails to comply with section 2080 as far as the notice provisions are concerned, leaving the policy language open to one of the four previously mentioned attacks. Insurers always prefer more stringent, restrictive or specific language, since it allows the insurer to deny more claims on technical grounds. These issues and alternatives are yet to be decided by the courts.

#### A. Late Notice and Prejudice

California cases hold that late notice will not bar recovery unless the insurer has been prejudiced. The court in *Associated Engineers, Inc. v. American National Fire Insurance Co.*,<sup>115</sup> held that where the insured discovered the loss in December, 1957, made and completed repairs to the broken sewer line in February, 1958, and gave notice to the carrier in March, 1958, the insurer was not prejudiced.<sup>116</sup> The

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112. See *Admiralty Fund v. Peerless Ins. Co.*, 143 Cal. App. 3d 379, 382, 191 Cal. Rptr. 753, 756 (1983).

113. *Id.* See also *infra* notes 149-50 and accompanying text.

114. CAL. INS. CODE § 2080 (West 1972).

115. 175 F. Supp. 352 (N.D. Cal. 1959).

116. *Associated Eng'rs*, 175 F. Supp. at 355. See also *Abrams v. American Fidelity & Casualty Co.*, 32 Cal. 2d 233, 195 P.2d 797 (1948); *Purefoy v. Pacific Auto. Indem. Exch.*, 5 Cal. 2d 81, 53 P.2d 155 (1955).



notice provision in the policy at issue in *Associated Engineers* was similar to the current sixty-day proof-of-loss provision, except that the insured had ninety, not sixty, days to file his proof.<sup>117</sup>

In *Moe v. Transamerica Title Insurance Co.*,<sup>118</sup> an action against a title insurer by the purchasers of a note secured by a trust deed, the court held:

It is settled that breach of a notice clause by an insured may not be asserted by an insurer unless the insurer was substantially prejudiced thereby; that prejudice is not presumed as a matter of law from such breach; and that the insurer has the burden of proving actual prejudice and not just a mere possibility of prejudice.<sup>119</sup>

Each case depends on its facts for a determination of prejudice.<sup>120</sup> The particular facts which might give rise to a carrier's prejudice defense include unreasonable delay in notice so as to jeopardize the insurer's subrogation rights. Since the insurer stands in the shoes of the insured for purposes of subrogation, if the insured waits over three years after discovery of damage to notify the carrier, the insurer may be barred by the California Code of Civil Procedure section 338 three year statute of limitations.<sup>121</sup> This would appear prejudicial since the insurer's subrogation potential against the third party whose negligence caused the damage to the home would evaporate. Similarly, if the insured waited a year after knowledge of the loss to notify the carrier, thereby permitting the ten-year statute of limitations for filing a claim against the developer<sup>122</sup> to run, a good argument of prejudice can be asserted.

In many instances, unlike a fire or theft loss, the insured is ignorant that property damage coverage under her homeowner's policy is available for latent defects. It is this lack of knowledge which often precipitates late notice. However, ignorance does not excuse the insured from filing a claim immediately after the loss is discovered. Prejudice may also result if the insured makes exterior property repairs without first obtaining expert opinions on the cause of the loss and appropriate methods of reasonable repair, thereby spending

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117. See *Associated Eng'rs*, 175 F. Supp. at 354.

118. 21 Cal. App. 3d 289, 98 Cal. Rptr. 547 (1971).

119. *Moe*, 21 Cal. App. 3d at 302, 98 Cal. Rptr. at 555 (citations omitted).

120. See *Reed v. Pacific Indem. Co.*, 101 Cal. App. 2d 151, 255 P.2d 255 (1950); *Gibson v. Colonial Ins. Co.*, 92 Cal. App. 2d 33, 206 P.2d 387 (1949); *Abrams*, 32 Cal. 2d 233, 195 P.2d 797 (1948).

121. CAL. CIV. PROC. CODE § 338 (West 1979).

122. *Id.* § 337.15 (or four years if the defect is patent).

hundreds or thousands of dollars more on repairs which are ineffective, useless or need to be redone.

Similarly, the leading case of *Hickman v. London Assurance Corp.*<sup>123</sup> states:

As the facts with respect to the amount and circumstances of a loss are almost entirely within the sole knowledge of the insured, and the opportunity and temptation to perpetuate a fraud upon the insurer is often great, it is necessary that it have some means of cross-examining, as it were, upon the written statement and proofs of the insured for the purpose of getting the exact facts before paying the sum claimed of it. Such conditions justify the provision universally to be met within policies, requiring the insured as often as demanded to submit to an examination under oath touching all matters material to the adjustment of the loss, and provisions of that character are held to be reasonable and valid.<sup>124</sup>

However, in a continuing and progressive damage situation such as earth movement, property damages may occur after the date of first manifestation and may, arguably be grounds for disposing of a prejudice argument particularly when the insured has not added to the damages. Often damage continues beneath the home for years prior to the time it manifests itself into noticable physical damage to the home. Certainly, the insured cannot prejudice the insurer's rights until the insured himself is aware he has a claim.

#### *B. When Does the Statute Begin to Run? Discovery of the Loss*

Putting possible prejudice aside, it must be determined when the loss "began" for purposes of the various statute of limitations defenses used by the insurer in a continuing subsidence loss claim (the notice defenses).<sup>125</sup> This topic has been one of heated debate and is currently widely litigated in the courts. The insurer argues that the first time a crack in any portion of the home appears, the statutes begin to run.<sup>126</sup> The insured argues that the statutes do not begin to run until the manifestation of the damage and its cause or causes are discoverable.

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123. 184 Cal. 524, 195 P. 45 (1920).

124. *Hickman*, 184 Cal. at 529-30, 195 P. at 48 (citations omitted).

125. This article is concerned solely with (1) twelve-month "suit against us," (2) twelve-month "notice of loss," (3) sixty-day proof of loss, and (4) four-year breach of contract (California Civil Code section 337) provisions.

126. For the insurer's view, see Zalma, *An Effective Defense to Claims of Continuing and Progressive First-Party Property Losses*, DAILY J. REP. 8 (1987).

The controversy was discussed in *Leaf v. City of San Mateo*.<sup>127</sup> There, the homeowners brought an action for subsidence damages resulting from defective sewage and drainage systems.<sup>128</sup> The court reasoned:

Defendant in this action takes the position that plaintiffs' cause of action accrued when plaintiffs became aware of the damage to their property, i.e., when they noticed the unlevel floors and cracks in the building exterior. Plaintiffs, on the other hand, urge the "rule of discovery," which would start a statute running only when plaintiffs not only were aware of the damage, but became aware of its negligent cause, i.e., at the time of the cave-in.

...

Although it has been said that a cause of action under the discovery rule accrues when the plaintiff discovers or should have discovered all facts essential to his cause of action, this has been interpreted under the discovery rule to be when 'plaintiff either (1) actually discovered his injury and its negligent cause or (2) could have discovered injury and cause through the exercise of reasonable diligence.' The discovery rule operates to protect the plaintiff who is 'blamelessly ignorant' of his cause of action. Accordingly, we do not think that plaintiffs' cause of action in this case should accrue from the occurrence of the last essential fact, nor from discovery of the damage to their property, as defendant contends, but rather from the point in time when plaintiffs became aware of defendants' negligence as a cause, or could have become so aware through the exercise of reasonable diligence.<sup>129</sup>

But in *Matsumoto v. Republic Insurance Co.*,<sup>130</sup> the court dismissed an insured's earth movement/third party negligence claim since the four-year statute of limitations for breach of contract was not tolled by the discovery rule.<sup>131</sup> The *Matsumoto* case, however, is an anomaly and easily limited to its facts. There, the subsidence at plaintiff's home was severe enough to make a backyard fence fall over. At that time, plaintiff sought advise from his lawyer and discovered that several of his neighbors had suffered similar damage to their homes and made insurance claims to their carriers. Still, Matsumoto waited several years before filing his claim with his carrier.

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127. 104 Cal. App. 3d 398, 163 Cal. Rptr. 711 (1980).

128. *Leaf*, 104 Cal. App. 3d at 402, 163 Cal. Rptr. at 713.

129. *Id.* at 406-08, 163 Cal. Rptr. at 715-16 (citations omitted).

130. 792 F.2d 869 (9th Cir. 1986).

131. *Matsumoto*, 792 F.2d at 872.

The *Matsumoto* decision is highly criticized in the detailed, but decertified, opinion of *Paul v. State Farm Fire & Casualty Co.*<sup>132</sup> There, the court allowed a delay of over four years from the point in which Paul's insurance agent denied his earth movement claim without investigation.<sup>133</sup>

Properly applying the "date-of-discovery" rule, the court reversed the trial court's ruling sustaining defendants' demurrer on the theory that defendants' fraudulent concealment, breach of fiduciary duties and estoppel preclude them from utilizing the four-year statute by backdating the date of loss.<sup>134</sup> Until the claimant has knowledge of the loss, and its negligent cause, the loss is not "discovered" for purposes of the notice defenses.

Two other recent cases have dealt with the applicability of the twelve month notice provisions.<sup>135</sup> In *Lawrence v. Western Mutual Insurance Co.*,<sup>136</sup> Lawrence, in 1968, built a home on a vacant lot in Bel Air, California. In 1974 and 1975, Lawrence suffered subsidence damage to his home. Geological studies done at that time showed that faulty drainage was the cause of the damage.

No further damage occurred until 1983, when heavy rains infiltrated the home's underlying soils. Soils reports were again obtained in 1983, concluding that the home was built on 36 feet of improperly compacted fill material. Lawrence spent over \$250,000 on geological studies and reconstruction of the foundation. Not until July 15, 1985 did Lawrence file a claim with his insurer.

132. 193 Cal. App. 3d 223, 238 Cal. Rptr. 428 (1987) (Pursuant to California Rules of Court sections 976(b) and 976.1, the California Supreme Court has ordered the *Paul* opinion depublished. As a result this case cannot be cited as authority in California courts.).

133. *Paul*, 193 Cal. App. at 237, 238 Cal. Rptr. at 436.

134. *Id.* The date of discovery rule has been applied in numerous circumstances. See, e.g. *Pacific-Southern Mortgage Trust Co. v. Insurance Co. of N. Amer.*, 166 Cal. App. 3d 703, 212 Cal. Rptr. 754 (1985) (the term 'discovery of loss'—under a commercial blanket bond—meant the time when the insured discovered it had suffered a loss, and not the time when it discovered it had a potential loss that began the running of the limitations period); *Allen v. Sundean*, 137 Cal. App. 3d 216, 186 Cal. Rptr. 863 (1982) (latent construction defects on home built in 1950s with improper fill; court rejected developer's statute of limitations defense because of homeowner's ignorance of the improper hillside fill); *Anderson v. Brouwer*, 99 Cal. App. 3d 176, 160 Cal. Rptr. 65 (1979) (latent construction defects) *But see Bellman v. County of Contra Costa*, 54 Cal. 2d 363, 353 P.2d 300, 5 Cal. Rptr. 692 (1960) (a new and separate cause of action arises with each new subsidence, with any applicable limitations statute running separately for each separate subsidence).

135. See *Lawrence v. Western Mutual Ins. Co.*, 204 Cal. App. 3d 565, 251 Cal. Rptr. 319 (1988); *Abari v. State Farm Fire & Casualty Co.*, 205 Cal. App. 3d 530, 252 Cal. Rptr. 565 (1988). The California Supreme Court has not yet determined whether or not to grant review on either case. Thus, we must wait to see if either case will remain publishable precedent.

136. 204 Cal. App. 3d 565, 251 Cal. Rptr. 319 (1988).

Lawrence urged that the "inception of the loss" is not the point when the damage is discovered, but rather when the insured knew or should have known that a loss has occurred which is covered by his insurance policy.<sup>137</sup> The court rightly disagreed with Lawrence that the notice provisions (twelve month and sixty day proof of loss) are not tolled until the insured is aware of a potential claim, but the occurrence of some cognizable event which would lead a reasonable person to discover the loss.<sup>138</sup> The *Lawrence* court further noted that the insurer was prejudiced by the delay since Lawrence had *completed repairs before making his claim and not allowed the insurer the opportunity to investigate*.<sup>139</sup>

In *Abari v. State Farm Fire & Casualty Co.*,<sup>140</sup> the appellate court affirmed the trial court's dismissal of plaintiff's second amended complaint following State Farm's demurrer.<sup>141</sup> In *Abari*, plaintiff pled that he discovered cracks in 1979, which progressively worsened over time.<sup>142</sup> In 1984, when Abari returned to his home (he had rented it to a third-party for 4 years), he noticed that the cracks had worsened.<sup>143</sup> Abari filed his claim with State Farm in early 1985.<sup>144</sup>

Upon review of the short *Abari* opinion, it seems that the court was looking for a way to allow Abari to continue his case against State Farm, but the complaint was simply too poorly pled. The court stated:

Abari submits the trial court should have rejected State Farm's argument that the cracks in 1979 put Abari on notice of subsidence. Abari urges on appeal the cracks may have been so small that no reasonable person would be put on notice of a subsidence problem.

It is conceivable the cracks were trivial, so that Abari was not alerted to the gravity of the damage. However, the complaint lacks such an allegation. As set forth ante, Abari merely pled he discovered the cracks in 1979; the cracks worsened over time; and upon reentering the property in 1984, after being an absentee landlord, he observed further damage.

The subject complaint was Abari's third attempt to state a cause of action against State Farm. In the earlier demurrers, State Farm

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137. *Lawrence*, 204 Cal. App. 3d at 571-72, 251 Cal. Rptr. at 322.

138. *Id.* at 573, 251 Cal. Rptr. at 323.

139. *Id.* at 574, 251 Cal. Rptr. at 324.

140. 205 Cal. App. 3d 530, 252 Cal. Rptr. 565 (1988).

141. *Abari*, 205 Cal. App.3d at 536, 252 Cal. Rptr. at 568.

142. *Id.* at 533, 252 Cal. Rptr. at 566.

143. *Id.*

144. *Id.*

called attention to Abari's failure to plead when damage arose. Abari had ample opportunity to plead his best case, as nearly two and one half years elapsed between the initial and second amended complaints.<sup>145</sup>

Neither *Lawrence* nor *Abari* discussed *Leaf v. San Mateo*.<sup>146</sup> However, these authorities, all good law at this point, are not inconsistent. *Leaf* restates the adage that the "discovery of the loss" occurs when the claimant knows or should know that there is a loss and its negligent cause.<sup>147</sup> In both *Lawrence* and *Abari*, the plaintiffs knew that they had a loss in 1975 and 1979, respectively, and were cognizant of the cause of the loss at that time. Consequently, it would seem that the courts are willing to look at subsidence losses, at least those in which the notice provisions have been asserted as a defense, on a case-by-case basis.

### C. The Validity of the Notice Defenses

The date on which the loss *began* for statute of limitations purposes is vital when discussing the notice defenses. Preliminarily, the policy defenses may fail if the insured is not formally made aware of the defenses' existence<sup>148</sup> or if the policy language is ambiguous.<sup>149</sup> The notice defenses can also be defeated under a theory of waiver or estoppel. During the claim investigation, if the insurer fails to reserve its rights or denies the claim based on the notice defenses, those defenses are waived.<sup>150</sup> Furthermore, "one cannot justify or equitably lull his adversary into a false sense of security, and thereby cause him to subject his claim to the bar of the statute of limitations, and then be permitted to plead the very delay caused by his conduct as a defense to the action when brought."<sup>151</sup> Hopefully, the tremendous amount of litigation regarding the notice defenses presently pending in the Cali-

145. *Id.* at 535, 252 Cal. Rptr. at 567.

146. 104 Cal. App. 3d 398, 163 Cal. Rptr. 711 (1980).

147. *Leaf*, 104 Cal. App. 3d at 408, 163 Cal. Rptr. at 716.

148. *See Sarchett v. Blue Shield*, 43 Cal. 3d 1, 729 P.2d 267, 233 Cal. Rptr. 76 (1987).

149. *Delgado v. Heritage Life Ins. Co.*, 157 Cal. App. 3d 262, 271, 203 Cal. Rptr. 672, 677 (1984).

150. *See Wagner v. Director*, 658 F. Supp. 1530, 1538 (C.D. Cal. 1987), *rev'd on other grounds*, 847 F.2d. 515 (9th Cir. 1988). *But see Becker v. State Farm Fire & Casualty Co.*, 664 F. Supp. 460, 461-62 (N.D. Cal. 1987) (twelve-month limitation is not waived if insured notifies insurer twelve months after the loss, despite the fact that insurer failed to reserve its rights when denying insured's claim).

151. *Industrial Indem. Co. v. Industrial Accident Comm'n*, 115 Cal. App. 2d 684, 252 P.2d 649, 689, 252 P.2d 649, 654 (1953).

fornia courts will force the Supreme Court to resolve these issues.

Each homeowner's policy requires a sworn proof of loss to be filed within sixty days of the loss. However, "it is not possible to prepare a proof of loss until a complete inspection of the damage may be accomplished and the full extent of the loss thereby ascertained."<sup>152</sup> In a subsidence case, then, a proof of loss could not be completed until a geologist or soils engineer performs phase one or phase two (if necessary) soils investigations and a contractor prepares a repair bid. At that point, the sixty days would begin to run.

The twelve-month policy limitation itself has passed constitutional muster,<sup>153</sup> and one court has said it is unambiguous.<sup>154</sup> As shown by the discussion of *Leaf*, *Lawrence*, *Paul*, *Abari*, and *Matsumoto*, the applicability of the twelve-month limitation, at present, is a question of fact to be determined on a case-by-case basis. As extensive litigation on this point continues, hopefully the Supreme Court will resolve the twelve-month applicability issue within the next few years.

*Zurn Engineers v. Eagle Star Insurance Co.*<sup>155</sup> sheds light on how the twelve-month provisions should be viewed:

[t]he phrase 'inception of the loss' must be construed in light of the other provisions of the policy, and that so construed in the context of the policy . . . the phrase does not mean the time at which the physical event causing damage to property occurred. Rather, it must be construed as occurring no earlier than the point at which the insured's reasonable belief of the third party's responsibility for the loss by reason of an uninsured case is countered by the third party's assertion that it is not responsible.

. . .

[i]f the right to sue upon an insurance policy is postponed by action that must be taken by the insured as a prerequisite to suit, the limitation period does not commence to run until the insured has an opportunity to comply with the conditions precedent to litigation.<sup>156</sup>

Under *Zurn*, it would seem that the twelve-month policy defenses would be tolled until the insured has the opportunity to, for example, make her claim, investigate to determine damages, and file a proof of loss—all before the twelve-month policy defenses begin to run.

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152. *Associated Eng'rs Inc. v. American Nat'l Fire Ins. Co.*, 175 F. Supp. 352 (1959).

153. *C & H Foods Co. v. Hartford Ins. Co.*, 163 Cal. App. 3d 1055, 211 Cal. Rptr. 765 (1985).

154. *State Farm Fire & Casualty Co. v. Martin*, 668 F. Supp. 1379, 1382 (C.D. Cal. 1987).

155. 61 Cal. App. 3d 493, 132 Cal. Rptr. 206 (1976). This case is discussed at length in *Lawrence v. Western Mutual Ins. Co.*, 204 Cal. App. 3d 565, 251 Cal. Rptr. 319 (1988).

156. *Zurn* at 495, 499, 132 Cal. Rptr. at 207, 210.

## V. CONCLUSION

A continuous, progressive subsidence loss which began prior to 1983 and which was proximately caused by an excluded peril (such as earth movement or flood) in conjunction with a non-excluded peril (such as third party negligence) is covered under the HO-3 Edition ISO "all risk" homeowner's policy. Each insurer who was on the risk prior to 1983 (when the policies were amended to exclude third party negligence) must share, pro rata, the costs to repair both the dwelling and the underlying or surrounding soils. For the most part, when the insurer cannot show prejudice, the statute of limitations defenses will be ineffective *unless* the insured had "discovered" her loss and has slept on her rights. Discovery of the loss includes knowing both the damage and its cause before the statutes begin to run. Technical defenses, which are disfavored, such as the sixty-day proof of loss requirement, cannot begin to run in a subsidence case until an investigation is completed and the damages are known. Finally, unless specifically reserved and explained, the policy defenses may be held invalid under the theory of waiver or estoppel, may be held to be ambiguous or may be re-written by the court. Due to the tremendous amount of subsidence litigation and the uncertainty created by the lack of definitive precedents, it is hoped that the California Supreme Court will provide guidance on these issues by rendering a decision on *Garvey* in the near future and by granting review on a case like *Lawrence*, *Abari* or *Home Insurance* to rule on the notice issues.



